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California State Controller

October 1, 2018

To: K-12 Local Education Agencies (School Districts, County Offices of Education, and Charter Schools), Joint Powers Entities, and Certified Public Accountants Performing Audits of California K-12 Local Education Agencies:

Subject: Annual Audits for Fiscal Year 2017-18

This advisory provides information to assist independent auditors in performing the fiscal year (FY) 2017-18 audits of Local Education Agencies (LEA) and joint powers entities.

This audit advisory and general guidelines for audits of K-12 LEAs are available on the State Controller's website at www.sco.ca.gov/aud_k12_lea.html.

2017-18 GUIDE FOR ANNUAL AUDITS OF K-12 LOCAL EDUCATION AGENCIES AND STATE COMPLIANCE REPORTING

The audit guide is published by the Education Audit Appeals Panel (EAAP) pursuant to rulemaking procedures and incorporated by reference in Title 5, *California Code of Regulations*, section 19810; the guide is available at www.eaap.ca.gov. The 2017-18 audit guide should be referenced as the *2017-18 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting* (2017-18 K-12 Audit Guide). Ensure that the applicable fiscal year is included in the title.

The number of procedures is no longer required to accompany the list of state compliance requirements.

PROCEDURAL

1. FY 2017-18 audit reports must be filed with the State Controller's Office (SCO), California Department of Education (CDE), local County Superintendent of Schools, and, if applicable, the chartering entity, by December 17, 2018. Independent auditors must submit to SCO one copy of the audit report by U.S. Postal Service or private carrier, or via File Transfer Protocol. Report submission instructions are posted on the SCO K-12 LEA website at www.sco.ca.gov/aud_k12_lea.html under the Submissions category.

Name the electronic report file according to the entity name, the document type, and fiscal year end. For example, for XYZ Unified School District, the following file names would be used:

- Report = XYZUnifiedRpt18.pdf
- Revisions = XYZUnifiedRevision18.pdf
- Revised Report = XYZUnifiedRevisedRpt18.pdf
- Management Letter Report = XYZUnifiedMgtLtr18.pdf
- Corrective Action Plan = XYZUnifiedCAP18.pdf

The electronic audit report files should be in **unsecured** PDF file format. Electronic files submitted in this format facilitate efficient processing of the annual audit reports.

2. The County Office of Education (COE) must submit its approved extension requests for submitting audit reports to SCO and CDE before December 17, 2018. The extension request must come from the COE and not the LEA or the certified public accountant (CPA). SCO will consent to the extension request only in extraordinary circumstances.

SCO does not grant extensions for charter school audits. An extension must be obtained through the chartering entity, and the chartering entity should notify SCO and CDE of the extension.

3. Charter school audit reports must contain on the cover the official name of the charter school according to the charter school agreement and the name in the CDE school directory. If the charter school has another name, both names should appear on the cover to facilitate SCO's processing of the audit report receipt. The SCO desk review process may be significantly delayed if the charter school audit reports are not properly identified.
4. The auditor rotation requirements specified in California Education Code section 41020(f)(2) apply to auditors who conduct LEA audits. This section of the Education Code makes it unlawful for a public accounting firm to provide audit services to the LEA if the lead audit partner, or coordinating audit partner responsible for the audit or for reviewing the audit, has performed audit services for the LEA in each of the six previous fiscal years. Consequently, a different audit firm and/or audit partners must be used in the seventh year, unless a waiver is obtained from the EAAP.
5. CPAs or public accountants planning to conduct LEA audits must be included in the SCO-published Certified Public Accountants Directory. To be included in the directory, the CPA or public accountant must submit a written request to SCO prior to conducting the audits. Instructions for submitting the request can be found at SCO's website at <http://cpads.sco.ca.gov/>.

In addition, if the auditor is performing an audit under the Uniform Guidance, the LEA must request a copy of the audit organization's peer review report, which the auditor is required to provide under generally accepted government auditing standards (Uniform Guidance Subpart F—Audit Requirements §200.509).

6. If the audit report contains a finding or findings that may be considered apportionment-significant, SCO will send the LEA a certification letter with information on its appeal rights. The LEA has 30 days from the date the U.S. Postal Service delivers the letter to request a summary review of any apportionment-significant audit finding or findings on the grounds of substantial compliance. In addition, the LEA has 60 days from delivery of the letter or 30 days following the conclusion of a summary review, with regard to the findings included in that review, to file a formal appeal of any apportionment-significant finding or findings on any of the grounds set forth in California Education Code section 41344(d). For more information on audit finding appeals, visit the EAAP website at <http://eaap.ca.gov/appeals/>.
7. CDE is accepting only electronic versions of the FY 2017-18 audit reports. For instructions on how to submit the annual audit reports to CDE, see <http://www.cde.ca.gov/fg/au/ag/submitauditrpt.asp>.
8. CDE has posted the Calculator for Estimating the Cost of an Audit Finding at <http://www.cde.ca.gov/fg/au/ag/statecomp.asp>. The calculator is designed to assist LEAs and auditors in estimating the costs associated with audit findings for school districts and charter schools for the Local Control Funding Formula (LCFF) unduplicated pupil counts, LCFF K-3 grade-span adjustment, and failure to comply with instructional time requirements.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD UPDATES FOR FISCAL YEAR 2017-18

The following Governmental Accounting Standards Board (GASB) statements are effective for the FY 2017-18 financial statement audits:

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. This Statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits, or OPEB). This Statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB.

- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*. The Statement is effective for periods beginning after December 15, 2016, and should be applied retroactively. Earlier application is encouraged.

- GASB Statement No. 85, *Omnibus 2017*. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.

STATE COMPLIANCE UPDATES FOR FISCAL YEAR 2017-18

The following compliance requirements and audit procedures were removed from the 2017-18 K-12 Audit Guide:

- **Mental Health Expenditures;** and
- **Immunizations.**

The following new compliance requirements and audit procedures were added to the 2017-18 K-12 Audit Guide:

- **Apprenticeship:** Related and Supplemental Instruction.

The following modifications/amendments in procedures were made to existing compliance requirements in the 2017-18 K-12 Audit Guide:

- **Schedule of Charter Schools:** The schedule in the Report Components section of the audit guide was revised to state that for each charter school, include the charter school number;
- **Kindergarten Continuance:** Procedure 1 was revised to obtain a list of pupils who turned six years old by September 1 and were enrolled in kindergarten for the year audited;
- **Middle or Early College High Schools:** Procedure 2 was clarified to include the Education Code section 46160(a)(2) provision to determine whether pupils met enrollment conditions;
- **Transportation Maintenance of Effort:** Procedure 2 was revised for determination of compliance requirements for LEAs that had transportation expenditures in FY 2012-13;
- **Educator Effectiveness:** Procedure 1 for adopting a plan was expanded to include “2017-18”. Clarified procedure 2 for determination of the compliance requirement. Revised procedure 3 to include a finding showing the full amount of Educator Effectiveness fund received as disallowed;
- **California Clean Energy Jobs Act:** Procedure 3 was revised to reference procedures 1 and 2. Procedure 4 was revised to remove reference to Public Resources Code section 26240(b);
- **After/ Before School Education and Safety Program:** Title of compliance requirement was modified to include “Before” program. Various procedures were clarified for compliance testing;
- **Proper Expenditure of Education Protection Account Funds:** Procedure 1 was clarified to include Article III, Section 36, Subdivision (e), Paragraph (6) of California Constitution;

- **Local Control and Accountability Plan (LCAP):** Various procedures were clarified for compliance testing to reflect the updated LCAP adoption; and
- **Independent Study-Course Based:** A note was included indicating that “An LEA must be audited for two consecutive years when operating an independent study-course based program. Thereafter, the program must be audited if the number of units of ADA reported is material as shown in the materiality level table.”

SINGLE AUDITS UNDER THE UNIFORM GUIDANCE

The following requirements are applicable if the LEA audit is subject to the single audit requirements under the Uniform Guidance:

1. Independent Auditor’s Report on the Financial Statements:

If the Schedule of Expenditures of Federal Awards (SEFA) is referenced in the “Other Information” section of the report, then the auditor should use the following words: Schedule of Expenditures of Federal Awards, as required by Title 2, *U.S. Code of Federal Regulations*, Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

2. Schedule of Expenditures of Federal Awards [(Uniform Guidance Subpart F—Audit Requirements §200.510(b))]:

- Uniform Guidance removes the previous flexibility available in Office of Management and Budget Circular A-133 and now requires the following to be presented on the face of the SEFA:
 - Total amounts provided to subrecipients from each federal program [§200.510(b)(4)];
 - The total federal awards expended for loan or loan guarantee programs [§200.510(b)(5)];
- The schedule must now include a total for each cluster of programs [§200.510(b)(3)]; and
- The notes to the schedule must include whether or not the auditee elected to use the 10 percent de minimis indirect cost rate [§200.510(b)(6)].

3. The Report on Compliance and Internal Control Over Compliance Applicable to Each Major Program:

For guidance and examples of reports on compliance with requirements that could have a direct and material effect on each major federal program and on internal control over compliance issued under the audit requirements of Uniform Guidance, refer to the American Institute of Certified Public Accountants’ *Government Auditing Standards and Single Audits* with conforming changes as of March 1, 2018.

4. Schedule of Findings and Questioned Costs:

- Updated terminology and references are incorporated into the Summary of Auditor’s Results in accordance with Uniform Guidance section 200.515(d)(1);

- Findings relating to the financial statements must be reported in accordance with generally accepted government auditing standards (GAGAS); and
- Findings and questioned costs for federal awards must include audit findings as defined in Uniform Guidance section 200.516 (a).

5. Audit Findings Follow-up:

- The corrective action plan and summary schedule of prior audit findings must include findings relating to the financial statements that are required to be reported in accordance with GAGAS [Uniform Guidance §200.511(a)];
- The summary schedule of prior audit findings must report the status of all audit findings included in the prior audit's schedule of findings and questioned costs [Uniform Guidance §200.511(b)]; and
- At the completion of the audit, the LEA must prepare, in a document separate from the auditor's findings described in Uniform Guidance section 200.516, a corrective action plan to address each audit finding included in the current-year auditor's report [Uniform Guidance §200.511(c)].

REPORT CERTIFICATION COMPLIANCE REMINDERS

During the annual audit report certification process, SCO spends a significant amount of time corresponding with independent auditors regarding audit report deficiencies. To expedite certification of audit reports for FY 2017-18, SCO requests that auditors address the following requirements when completing their audit reports. Failure to comply with these requirements will result in audit reports being rejected:

1. **LEA Organization Structure Description:** The description must be presented in the Supplementary Information section of the audit report as required in the 2017-18 K-12 Audit Guide (Report Components 4.a.).
2. **Schedule of Average Daily Attendance (ADA):** If there are any ADA adjustments due to audit findings, the schedule must display additional columns for the Second Period and Annual Reports reflecting the final ADA after audit finding adjustments, as required by the 2017-18 K-12 Audit Guide (Report Components 4.b.).

The schedule of ADA for charter schools must display total ADA and ADA that is generated through classroom-based instruction by grade span. For LEAs that include one or more charter schools in their financial statements, total ADA and classroom-based ADA for each charter school must be presented.

3. **Schedule of Instructional Time:** When a charter school is included in the sponsoring entity's audit report, a separate Schedule of Instructional Time for each classroom-based charter school must be included in the supplementary information section of the audit report as required by the 2017-18 K-12 Audit Guide (Report Components 4.c.).

The following are also required:

- For charter school reports, include the number of instructional days offered in the schedule of instructional time; and
 - For school district reports, include a note stating whether the district participated in longer-day incentives and whether the district met or exceeded its Local Control Funding Formula target funding.
4. **State Compliance Findings:** The financial impact of state compliance findings must be quantified, as applicable. The 2017-18 K-12 Audit Guide includes specific information that must be included in each finding. For example, for attendance findings, the 2017-18 K-12 Audit Guide requires that the audit report include a statement of the number of units of ADA that were inappropriately reported for apportionment and an estimate of their dollar value.

If quantification of financial impact is required to be included in a finding and the auditor determines that there is no financial impact based on the procedures performed, then the finding must describe the reasons for the auditor's conclusion.

The stated criteria should refer to a California state law or regulation that governs the program. It is not appropriate to cite the 2017-18 K-12 Audit Guide as the criterion.

5. **Federal Compliance Findings:** For single audits under Uniform Guidance, Federal award findings must be presented in accordance with Uniform Guidance, Subpart F—Audit Requirements, section 200.516(a)(b)(c), as follows:
- **Reference number(s):** Each audit finding must include a reference number in the format meeting the requirements of the data collection form submission required by section 200.512 – Report submission, paragraph (b). The format is 201X-XXX;
 - **Federal program(s) information:** Catalog of Federal Domestic Assistance (CFDA) number and title, identification number and fiscal year, name of the federal agency and pass-through entity;
 - **Criteria or specific requirement:** Statutory, regulatory, or other citation;
 - **Condition:** Facts that support the deficiency in the audit finding;
 - **Cause:** Statement of cause that identifies the reason or explanation for the condition or the factors responsible for the finding;
 - **Effect:** Clear, logical link to establish the impact or potential impact of the difference between the condition and criteria;
 - **Questioned costs:** Identification of questioned costs and how they were computed; known questioned costs must be identified by applicable CFDA number(s) and applicable federal award identification number(s);
 - **Context:** Information to provide proper perspective for judging the prevalence and consequences of the audit findings, such as whether the audit finding represents an

isolated instance or a systematic problem. The auditor should report whether the sampling was a statistically valid sample;

- **Identification as a repeat finding:** Identification of whether the audit finding was a repeat of a finding in the immediately prior audit and, if so, any applicable prior-year audit finding number(s);
 - **Recommendation:** Information to prevent future occurrences of the deficiency identified in the audit finding(s); and
 - **Views of responsible officials:** Views of the auditee and planned corrective actions.
6. **Elements of Audit Findings:** Each audit finding should be presented in the level of detail described in the Findings and Recommendations section of the 2017-18 K-12 Audit Guide (Report Components, 6.a.).

OTHER

The SCO's FY 2017-18 LEA Desk Review Checklist will be available on the SCO website at www.sco.ca.gov/aud_k12_lea.html by October 31, 2018.

If you have any questions or need additional information, please contact the Division of Audits, LEA Unit, by telephone at (916) 324-6442 or by email at leaaudits@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA, Chief
Division of Audits
State Controller's Office

JVB/as

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cc: Tom Torlakson, State Superintendent of Public Instruction
California Department of Education